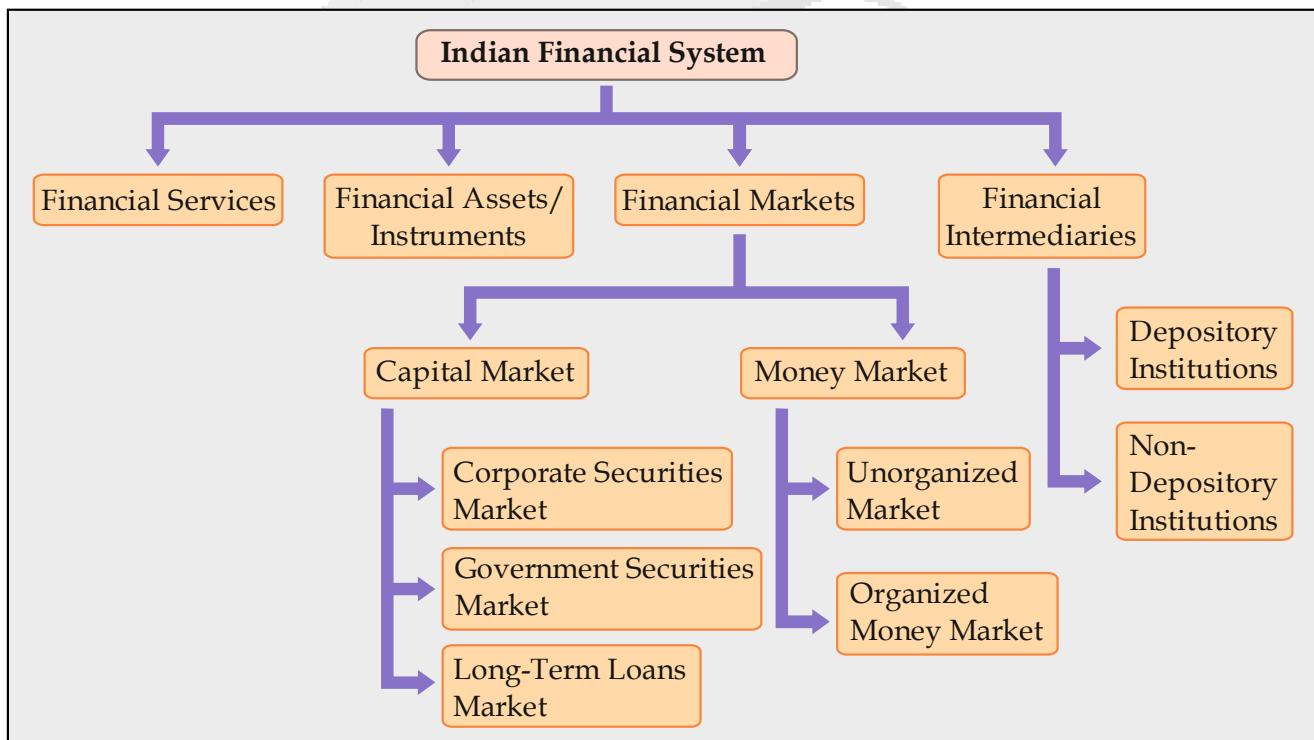


## 1. Overview of Indian Financial System

### Introduction

The financial system of a country is an important tool for economic development of the country as it helps in the creation of wealth by linking savings with investments. It facilitates the flow of funds from the households (savers) to business firms (investors) to aid in wealth creation and development of both the parties. The institutional arrangements include all condition and mechanism governing the production, distribution, exchange and holding of financial assets or instruments of all kinds. There are four main constituents of the financial system as follows:



### 1. Financial Services

Financial Services are concerned with the design and delivery of financial instruments, advisory services to individuals and businesses within the area of banking and related institutions, personal financial planning, leasing, investment, assets, insurance etc. These services include

- **Banking Services :** Includes all the operations provided by the banks including to the simple deposit and withdrawal of money to the issue of loans, credit cards etc.
- **Foreign Exchange Services :** Includes the currency exchange, foreign exchange banking or the wire transfer.

- **Investment Services** : It generally includes the asset management, hedge fund management and the custody services.
- **Insurance Services** : It deals with the selling of insurance policies, brokerages, insurance underwriting or the reinsurance.
- Some of the other services include advisory services, venture capital, angel investment etc.

## 2. Financial Instruments/Assets

Financial Instruments can be defined as a market for short-term money and financial assets that is a substitute for money. The term short-term means generally a period of one year substitutes for money is used to denote any financial asset which can be quickly converted into money. Some of the important instruments are as follows:

- **Call /Notice-Money** : *Call/Notice money is the money borrowed on demand for a very short period. When money is lent for a day it is known as Call Money. Intervening holidays and Sunday are excluded for this purpose. Thus money borrowed on a day and repaid on the next working day is Call Money. When the money is borrowed or lent for more than a day up to 14 days it is called Notice Money.* No collateral security is required to cover these transactions.
- **Term Money** : *Deposits with maturity period beyond 14 days is referred to as the term money.* The entry restrictions are the same as that of Call/Notice Money, the specified entities not allowed to lend beyond 14 days.
- **Treasury Bills**: *Treasury Bills are short-term (up to one year) borrowing instruments of the union government.* It's a promise by the Government to pay the stated sum after the expiry of the stated period from the date of issue (less than one year). They are issued at a discount off the face value and on maturity, the face value is paid to the holder.
- **Certificate of Deposits** : Certificate of Deposits is a money market instrument issued in dematerialised form or as a Promissory Note for funds deposited at a bank, other eligible financial institution for a specified period.
- **Commercial Paper** : CP is a note in evidence of the debt obligation of the issuer. On issuing commercial paper the debt is transformed into an instrument. CP is an unsecured promissory note privately placed with investors at a discount rate of face value determined by market forces.

## 3. Financial Markets

The financial markets are classified into two groups:

### Capital Market

A *capital market* is an organised market which provides long-term finance for business. Capital Market also refers to the facilities and institutional arrangements for borrowing and lending long-term funds. Capital Market is divided into three groups:

- **Corporate Securities Market** : Corporate securities are equity and preference shares, debentures and bonds of companies. The corporate security market is a very sensitive and active market. It can be divided into two groups: primary and secondary.

- **Government Securities Market :** In this market government securities are bought and sold. The securities are issued in the form of bonds and credit notes. The buyers of such securities are Banks, Insurance Companies, Provident funds, RBI and Individuals.
- **Long-Term Loans Market :** Banks and Financial institutions that provide long-term loans to firms for modernization, expansion and diversification of business. Long-Term Loan Market can be divided into Term Loans Market, Mortgages Market and Financial Guarantees Market.

### Money Market

Money Market is the market for short-term funds. The money market is divided into two types :

- **Unorganized Market :** It consists of Moneylenders, Indigenous Bankers, Chit Funds, etc.
- **Organized Money Market :** It consists of Treasury Bills, Commercial Paper, Certificate of Deposit, Call Money Market and Commercial Bill Market. Organised Markets work as per the rules and regulations of RBI. RBI controls the Organized Financial Market in India.

## 4. Financial Intermediaries

*A financial intermediary is an institution which connects the deficit and surplus money.* The best example of an intermediary is a bank which transforms the bank deposits to bank loans. The role of the financial intermediary is to distribute funds from people who have an extra inflow of money to those who don't have enough money to fulfil the needs. Functions of Financial Intermediary are as follows:

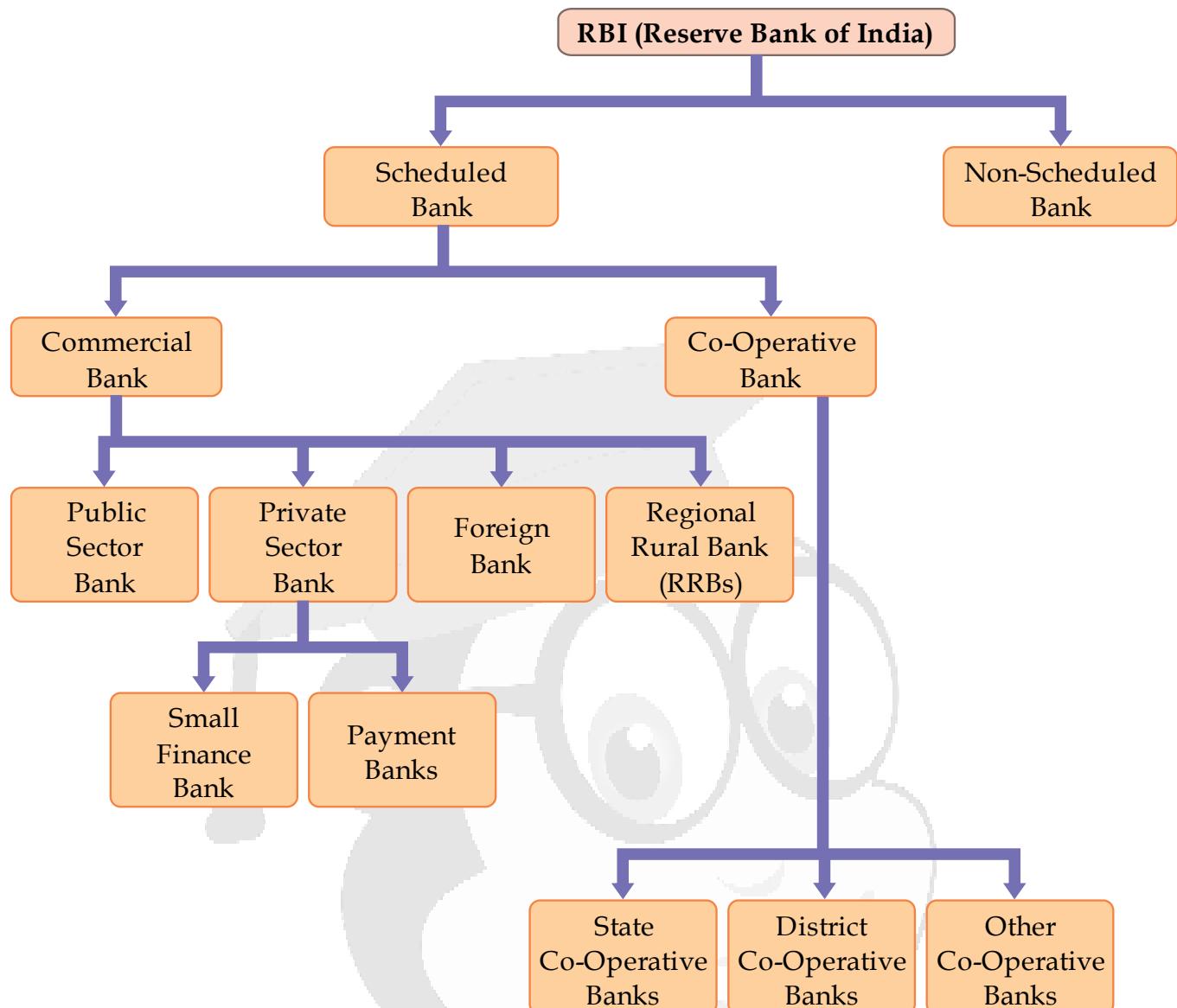
- **Maturity Transformation :** Deals with the conversion of short-term liabilities to long-term assets.
- **Risk Transformation :** Conversion of risky investments into relatively risk-free ones.
- **Convenience Denomination :** It is a way of matching small deposits with large loans and large deposits with small loans.

Financial Intermediaries are divided into two types :

**Depository Institutions :** These are banks and credit unions that collect money from the public and use that money to advance loans to financial customers.

**Non-Depository Institutions :** These are brokerage firms, insurance and mutual funds companies that cannot collect money deposits but can sell financial products to financial customers.

## Types of Banks



## Bank Classification in India

There are two broad categories under which banks are classified in India-

- (1) Scheduled Bank
- (2) Non-Scheduled Banks

### (1) Scheduled Bank

*Scheduled Banks as the name suggest are the banks, which are accounted in the Second Schedule of the Reserve Bank of India (RBI) Act, 1934.* To qualify as a scheduled bank, the bank should conform to the following conditions:

1. The total minimum value of paid up capital and reserve must be of Rs. 5 lacs.
2. The bank requires to satisfy the central bank that its affairs are not carried out in a way that causes harm to the interest of the depositors.
3. The bank needs to be a corporation rather than a sole-proprietorship or partnership firm.

However, they are required to fulfil certain obligations like maintenance of an average daily balance of CRR (Cash Reserve Ratio) with the central bank at the rates specified by it. These banks need to submit returns at regular intervals, to the central bank subject to the rules of Reserve Bank of India Act, 1934 and Banking Regulation Act, 1949.

**Types of Scheduled Banks :** The scheduled banks include :

- (A) Commercial Banks
- (B) Co-Operative Banks

**(A) Commercial Banks :** A commercial bank is a financial institution which performs the functions of accepting deposits from the general public and giving loans for investment with the aim of earning profit.

### Functions of Commercial Banks

- (1) Primary Function
- (2) Secondary Functions

#### (1) Primary Function

**1. Accepting Deposits :** It is the most important function of commercial banks.

They accept deposits in several forms according to requirements of different sections of the society.

The main kinds of deposits are :

**(i) Current Account Deposits or Demand Deposits :** These deposits refer to those deposits which are repayable by the banks on demand:

1. Such deposits are generally maintained by businessmen with the intention of making transactions with such deposits.
2. They can be drawn upon by a cheque without any restriction.
3. Banks do not pay any interest on these accounts. Rather, banks impose service charges for running these accounts.

**(ii) Fixed Deposits or Time Deposits:** Fixed deposits refer to those deposits, in which the amount is deposited with the bank for a fixed period of time.

1. Such deposits do not enjoy cheque-able facility.
2. These deposits carry a high rate of interest.

Basis	Demand Deposits	Fixed Deposits
Cheque facility	They are chequeable deposits.	They are non-chequeable deposits.
Interest payments	They do not carry any interest.	They carry interest which varies directly with the period of time.
Number of transactions	The depositor can make any number of transactions for deposit or withdrawal of money.	Depositor generally makes only two transactions: (i) Deposit of Money in the beginning; (ii) Withdrawal of money on maturity.

**(iii) Saving Deposits :** These deposits combine features of both current account deposits and fixed deposits :

1. The depositors are given cheque facility to withdraw money from their account. But, some restrictions are imposed on number and amount of withdrawals, in order to discourage frequent use of saving deposits.
2. They carry a rate of interest which is less than interest rate on fixed deposits. It must be noted that Current Account deposits and saving deposits are chequable deposits, whereas, fixed deposit is a non-chequable deposit.

**2. Advancing of Loans :** The deposits received by banks are not allowed to remain idle. So, after keeping certain cash reserves, the balance is given to needy borrowers and interest is charged from them, which is the main source of income for these banks.

Different types of loans and advances made by Commercial banks are :

- (i) **Cash Credit :** Cash credit refers to a loan given to the borrower against his current assets like shares, stocks, bonds, etc. A credit limit is sanctioned and the amount is credited in his account. The borrower may withdraw any amount within his credit limit and interest is charged on the amount actually withdrawn.
- (ii) **Demand Loans :** Demand loans refer to those loans which can be recalled on demand by the bank at any time. The entire sum of demand loan is credited to the account and interest is payable on the entire sum.
- (iii) **Short-term Loans :** They are given as personal loans against some collateral security. The money is credited to the account of borrower and the borrower can withdraw money from his account and interest is payable on the entire sum of loan granted.

## (2) Secondary Functions

1. **Overdraft Facility :** It refers to a facility in which a customer is allowed to overdraw his current account upto an agreed limit. This facility is generally given to respectable and reliable customers for a short period. Customers have to pay interest to the bank on the amount overdrawn by them.
2. **Discounting Bills of Exchange :** It refers to a facility in which holder of a bill of exchange can get the bill discounted with bank before the maturity. After deducting the commission, bank pays the balance to the holder. On maturity, bank gets its payment from the party which had accepted the bill.
3. **Agency Functions :** Commercial banks also perform certain agency functions for their customers. For these services, banks charge some commission from their clients.

Some of the agency functions are :

- (i) **Transfer of Funds:** Banks provide the facility of economical and easy remittance of funds from place-to-place with the help of instruments like demand drafts, mail transfers, etc.
- (ii) **Collection and Payment of Various Items:** Commercial banks collect cheques, bills, interest, dividends, subscriptions, rents and other periodical receipts on behalf of their customers and also make payments of taxes, insurance premium, etc. on standing instructions of their clients.

- (iii) **Purchase and Sale of Foreign Exchange:** Some commercial banks are authorized by the central bank to deal in foreign exchange. They buy and sell foreign exchange on behalf of their customers and help in promoting international trade.
- (iv) **Purchase and Sale of Securities:** Commercial banks buy and sell stocks and shares of private companies as well as government securities on behalf of their customers.
- (v) **Income Tax Consultancy:** They also give advice to their customers on matters relating to income tax and even prepare their income tax returns.
- (vi) **Trustee and Executor:** Commercial banks preserve the wills of their customers as trustees and execute them after their death as executors.
- (vii) **Letters of Reference:** They give information about the economic position of their customers to traders and provide the similar information about other traders to their customers.

**4. General Utility Functions :** Commercial banks render some general utility services like :

- (i) **Locker Facility:** Commercial banks provide facility of safety vaults or lockers to keep valuable articles of customers in safe custody.
- (ii) **Traveller's Cheques:** Commercial banks issue traveler's cheques to their customers to avoid risk of taking cash during their journey.
- (iii) **Letters of Credit:** They also issue letters of credit to their customers to certify their creditworthiness.
- (iv) **Underwriting Securities:** Commercial banks also undertake the task of underwriting securities. As public has full faith in the creditworthiness of banks, public do not hesitate in buying the securities underwritten by banks.
- (v) **Collection of Statistics:** Banks collect and publish statistics relating to trade, commerce and industry. Hence, they advise customers on financial matters. Commercial banks receive deposits from the public and use these deposits to give loans. However, loans offered are many times more than the deposits received by banks. *This function of banks is known as 'Money Creation'.*

**Types of commercial Banks :** The commercial banks include

- (a) **Public Sector Banks**
- (b) **Private Sector Banks**
  - (i) Small Finance Banks
  - (ii) Payments Banks
- (c) **Foreign Banks**
- (d) **Regional Rural Banks**

#### **(a) Public Sector Banks**

These are banks where majority stake is held by the Government of India. Government holdings are more than 50% in public sector banks. The public sector accounts of 75 percent of total banking business in India.

In July 1969, 14 banks with a deposit base of Rs.50 crores or more were nationalized. Again in 1980, six more private banks were nationalized, bringing up the number to twenty

All those banks which were taken over through Banking Companies (Acquisition and transfer of Undertaking) Bill are called Nationalized Banks. Govt. of India issued an ordinance (Banking Companies ordinance, 1969 and Nationalized 14 Largest commercial banks in India form the midnight of 19th July, 1969.

These banks at that time contained 85% of bank deposits in India. Similarly in 1980, Govt. of India again nationalized 6 more banks. Thus, in total 20 banks were nationalized. Out of these New Bank of India was merged with PNB in 1993.

### **State Bank of India Merger**

**Table :** SBI-Post Merger List of OLD and NEW BIC (Bank Identifier Code) for Associate Banks

Sr. No.	Name of Erstwhile Abs	Effective date to use New BICs
1	State Bank of Travancore (SBTRINBB)	24 <sup>th</sup> April 2017
2	State Bank of Mysore (SBMYINBB)	8 <sup>th</sup> May 2017
3	State Bank of Bikaner and Jaipur (SBBJINBB)	15 <sup>th</sup> May 2017
4	State Bank of Patiala (STBPINBB)	22 <sup>nd</sup> May 2017
5	State Bank of Hyderabad (SBHYINBB)	29 <sup>th</sup> May 2017
6	Bhartiya Mahila Bank (BMB)	01-Apr-17

### **PSBs Major Mergers**

**Bank Merger List 2019 India:** Government of India (GoI) has announced the **third round of bank merger plan** to revive public sector banks along “with flagging economy from five year low. **Finance minister Nirmala Sitharaman recently** declared the merger plan of 10 public banks into four. As per the finance minister, the merger would help to manage the capital more efficiently. The amalgamation of the PSBs is based on bad loans intensity and regional factors.

After the mergers, the country will have **12 public sector banks**, including **State Bank of India (SBI)** and **Bank of Baroda (BOB)**.

The government is seriously considering to reduce the number of **public sector banks** (PSBs) from the existing **21 to 12** with a view to create **3-4 global sized** banks.

#### **All four merger separately**

##### **Merger Number 1: PNB+OBC+UBI**

Oriental Bank of Commerce (OBC) and United Bank of India (UBI) are merged with the Punjab National Bank (PNB). So after this merger now the PNB will be second largest Public Sector Banks of India after the State Bank of India in terms of branch network.

##### **Merger Number 2: Syndicate Bank+ Canara Bank**

Syndicate Bank is merged with the Canara Bank. After this merger; the Canara bank would be fourth largest Public Sector of India.

This merger would reduce the cost of operations due to network overlaps. These two banks have similar work culture that is why it would lead to facilitate a smooth transition.

##### **Merger Number 3: Andhra Bank+ Corporation Bank+ Union Bank of India**

Andhra Bank and Corporation Bank are merged with Union Bank of India. This merger would make Union Bank of India 5th largest Public Sector Bank.

### **Merger Number 4: Allahabad Bank + Indian Bank**

In the fourth merger the Indian bank would be merged with the Allahabad Bank. After the merger Allahabad bank would be 7th largest Public Sector Bank of India.

**Post the mega-merger, the six PSU banks that will remain independent** are as follows:

1. Indian Overseas Bank,
2. UCO Bank,
3. Bank of Maharashtra,
4. Punjab and Sind Bank
5. Bank of India, and
6. Central Bank of India.

**Note :** Last year, the government had merged Dena Bank and Vijaya Bank with Bank of Baroda, creating the **third-largest bank** by loans in the country.

### **(b) Private Sector Banks**

**Private Sector Banks :** *The "private-sector banks" are banks where greater parts of stake or equity are held by the private shareholders and not by government.* Banking in India has been dominated by public sector banks since the 1969 when all major banks were nationalized by the Indian government. However since liberalization in government banking policy in 1990s, old and new private sector banks have re-emerged.

#### **Conditions of Private Bank**

- The initial minimum paid-up voting equity capital for a bank shall be 500 crore rupees. Thereafter, the bank shall have a minimum net worth of 500 crore rupees at all times.
- Resident individuals and professionals having 10 years of experience in banking and finance at a senior level are also eligible to promote universal banks.
- Large industrial houses are excluded as eligible entities but are permitted to invest in the banks up to 10 per cent.
- Non-Operative Financial Holding Company (NOFHC) is non-mandatory in case of promoters being individuals or stand-alone promoting or converting entities who do not have other group entities.
- Not less than 51 per cent of the total paid-up equity capital of the NOFHC shall be owned by the promoter or the promoter group, instead being wholly owned by the promoter group.
- Foreign shareholding in the bank would be as per the existing foreign direct investment policy subject to the minimum promoter shareholding requirement. At present, the aggregate foreign investment limit is 74 per cent.
- Existing specialized activities have been permitted to be continue from a separate entity proposed to be held under the NOFHC subject to prior approval from the Reserve Bank.
- The business plan submitted by the applicant should be realistic and viable and address how the bank proposes to achieve financial inclusion.
- The bank shall get its shares listed on the stock exchanges within six years of the commencement of business by the bank.

- The bank shall open at least 25 per cent of its branches in unbanked rural centers and should comply with the priority sector lending targets and sub-targets as applicable to the existing domestic scheduled commercial banks.

Private shareholders hold majority stakes in private sector banks. Reserve Bank of India lays down all the rules and regulations. Following are the private sector banks in India:

1. HDFC BANK
2. ICICI BANK
3. AXIS BANK
4. YES BANK
5. INDUSIND BANK
6. KOTAK MAHINDRA BANK
7. DCB BANK
8. BANDHAN BANK
9. IDFC BANK
10. CITY UNION BANK
11. TAMILNAD MERCANTILE BANK
12. NAINITAL BANK
13. CATHOLIC SYRIAN BANK
14. FEDERAL BANK
15. JAMMU AND KASHMIR BANK
16. KARNATAKA BANK
17. DHANALAXMI BANK
18. SOUTH INDIAN BANK
19. LAKSHMI VILAS BANK
20. RBL BANK
21. KARUR VYSYA BANK
22. IDBI BANK

Further, We can classify private banks into two Categories :

#### (i) Small Finance Banks

##### Scope of Activities of SFBs

- The small finance banks shall primarily undertake basic banking activities of **acceptance of deposits and lending** to unserved and underserved sections including small business units, small and marginal farmers, micro and small industries and unorganised sector entities.
- There will not be any restriction in the area of operations of small finance banks.

##### Criteria for Setting up SFBs

- Individuals/professions with 10 years of experience in finance, Non-Banking Financial Companies (NBFCs), micro finance companies, local area banks are eligible to set up SFBs.
- The minimum paid-up equity capital for small finance banks shall be Rs. 100 crore.

- The promoter's minimum initial contribution to the paid-up equity capital of such small finance bank shall at least be 40 per cent and gradually brought down to 26 per cent within 12 years from the date of commencement of business of the bank.
- The foreign shareholding in the small finance bank would be as per the Foreign Direct Investment (FDI) policy for private sector banks as amended from time to time.
- The small finance banks will be required to extend 75 per cent of its Adjusted Net Bank Credit (ANBC) to the sectors eligible for classification as priority sector lending (PSL) by the Reserve Bank.
- SFBs have to maintain Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR) as per RBI norms.
- At least 50 per cent of its loan portfolio should constitute loans and advances of up to Rs. 25 lakh.

These banks cater to a niche segment in the society and help with financial inclusion of sections which are not taken care of by other leading banks. They look after micro industries, unorganized sector, small farmers etc. RBI and FEMA are the governing bodies of these banks.

These are :

1. AU SMALL FINANCE BANK
2. CAPITAL SMALL FINANCE BANK
3. FINCARE SMALL FINANCE BANK
4. EQUITAS SMALL FINANCE BANK
5. ESAF SMALL FINANCE BANK
6. SURYODAY SMALL FINANCE BANK
7. UJJIVAN SMALL FINANCE BANK
8. UTKARSH SMALL FINANCE BANK
9. NORTHEAST SMALL FINANCE BANK
10. JANA SMALL FINANCE BANK

## (ii) Payments Bank

### Scope of Activities

- Acceptance of demand deposits-Payments bank will initially be restricted to holding a maximum balance of **Rs. 100,000 per individual customer.**
- Issuance of ATM/debit cards - Payments banks, however, **cannot issue credit cards.**
- Payments and remittance services through various channels.
- Business Correspondents (BC) of another bank, subject to the Reserve Bank guidelines on BCs.
- Distribution of non-risk sharing simple financial products like mutual fund units and insurance products, etc.
- The payments bank **cannot undertake lending activities.**

## Criteria for Setting up Payment Banks

- Existing non-bank Pre-paid Payment Instrument (PPI) issuers; and other entities such as individuals / professionals; Non-Banking Finance Companies (NBFCs), corporate Business Correspondents (BCs), mobile telephone companies, supermarket chains, companies, real sector cooperatives; that are owned and controlled by residents; and public sector entities may apply to set up payments banks.
- Promoter/promoter groups should be 'fit and proper' with a sound track record of professional experience or run their businesses for at least a period of five years in order to be eligible to promote payments banks.
- The minimum paid-up equity capital for small finance banks shall be Rs. 100 crore.
- Maintains minimum 75% of deposits in Government bond and maximum 25% deposits with other scheduled commercial banks.
- The promoter's minimum initial contribution to the paid-up equity capital of such payments bank shall at least be 40 per cent for the first five years from the commencement of its business.
- The bank should have a high powered Customer Grievances Cell to handle customer complaints.
- The operations of the bank should be fully networked and technology driven from the beginning, conforming to generally accepted standards and norms.

## What can Payment Banks do?

- Offer internet banking, sell mutual funds, insurance and pensions.
- Have business correspondents and ATMs.
- Offer bill payment service for customers
- They can enable transfers and remittances from a mobile phone.
- They can offer forex services at charges lower than bank
- They can provide forex cards to travellers, usable as debit or ATM card all over India.
- They can also offer card acceptance mechanism to third parties such as "Apple Pay".

In the year 2015, to be specific 19th August 2015, Reserve Bank of India (RBI) gave "in principal approvals" to 11 entities to establish payment banks in India.

## List of Payment Banks in India: Active Services

Payment Banks with Full-fledged Services :

- Airtel Payments Bank
- India Post Payments Bank
- Fino Payments Bank
- Paytm Payments Bank

## Payment Banks with Limited Services

- NSDL Payments Bank
- Jio Payments Bank

### (c) Foreign Banks

A bank operating as a private entity in India but headquartered in a Foreign country is a foreign bank. They are governed by both the country they are located in as well the country they have headquarters in. Some of these are:

1. CITI Bank
2. Standard Chartered Bank
3. HSBC Bank

### The Role of Foreign Banks in India

- Enhance competition in the banking sector
- Technology and Local banks has been investing on financial innovation
- Modern banking services expanded
- Enhanced customer satisfaction
- Enhanced Provision of foreign currency to corporations
- Foreign banks participation in foreign exchange and money market contribute for deepening of financial system

### (d) Regional Rural Banks

Rural Banking in India started since the establishment of banking sector in India. In RBI Act section 54 provide provision for rural credit and banking. The Narsimham Committee -I (1991) recommended need of regional oriented rural bank which provide solution problems and requirements of the rural people.

Rural banking has become integral to the Indian financial markets with a majority of Indian population still living in rural or semi-urban areas. Government of India and the Reserve Bank of India have been continuously working to achieve complete financial inclusion i.e. timely and sufficient access to financial services and credit at an affordable cost, in the vast expanse of our country.

*Pradhan Mantri Jan Dhan Yojana is one of the recent initiatives by the new government which has definitely contributed to bring banking to every household.* This scheme with time will significantly reduce the gap between rural and urban areas in terms of financial inclusion but the fact that about 70% of population of India is still rural and the penetration of banking facilities is as low as only 24% i.e. only this percentage of people in these areas have formal bank accounts, cannot be ignored.

Regional Rural Banks were established under the provisions of an ordinance promulgated on the **26th September 1975 and the RRB Act, 1976** with an objective to ensure sufficient institutional credit for agriculture and other rural sectors. The area of operation of RRBs is limited to the area as notified by Govt. of India covering one or more districts in the State.

The area of operation of a majority of the RRBs is limited to a notified area comprising a few districts in a State. SBI has 14 Regional Rural Banks in India known as RRBs. Apart from SBI, there are other few banks which functions for the development of the rural areas in India.

RRBs are jointly owned by Govt. of India the concerned State Government and Sponsor Banks ,the issued capital of a RRB is shared by the owners in the proportion of 50%, 15% and 35% respectively.

**Prathama bank** is the first Regional Rural Bank in India located in the city.

RBI has also encouraged the spread of these banks by undertaking the following :

- Allowing non-target group financing for RRBs.
- Recapitalization and restructuring of RRBs.

Simplification of lending procedures as per Gupta Committee recommendations

- Special credit plans
- Kisan Credit Cards
- Deregulation of lending rates
- Direct financing for SCBs
- Various relaxations in investment policies and non-fund business
- Allowing direct access to refinance assistance at concessional rates for RRBs.

### Main Features are of RRBs

1. Supporting rural and semi-urban region financially.
2. Pension distribution and Wage disbursement of MGNREGA workers.
3. Added banking facilities like locker, cards-debit, and credit.

### (B) Co-Operative Banks

A co-operative bank is a financial entity which belongs to its members, who are at the same time the owners and the customers of their bank. Co-operative banks are often created by persons belonging to the same local or professional community or sharing a common interest. Co-operative banks generally provide their members with a wide range of banking and financial services (loans, deposits, banking accounts, etc).

- They provide limited banking products and are specialists in agriculture-related products.
- Cooperative banks are the primary financiers of agricultural activities, some small-scale industries and self-employed workers.
- Co-operative banks functions on the basis of "no-profit no-loss".
- Anyonya Co-operative Bank Limited (ACBL) is the first co-operative bank in India located in the city of Vadodara in Gujarat.

### Types of Co-Operative Bank

The co-operative banking structure in India is divided into following categories :

- (1) State Co-operative Banks
- (2) District/Central Co-operative Banks
- (3) Other Co-operative banks

**(1) State Co-operative Banks (SCBs) :** The state Co-operative Banks, now 33 (in 2019) in number, they finance, co-ordinate and control the working of the central Co-operative Banks in each state. They serve as the link between the Reserve bank and the general money market on the one side and the central co-operative and primary societies on the other. They obtain their funds mainly from the general public by way of deposits, loans and advances from the Reserve Bank and they are own share capital and reserves.

**(2) District/Central Co-operative Banks (CCBs) :** The central co-operative banks are located at the district headquarters or some prominent town of the district. These banks have a few private individuals also who provide both finance and management. The central co-operative banks have three sources of funds,

- Their own share capital and reserves
- Deposits from the public and
- Loans from the state co-operative banks

Their main function is to lend to primary credit society apart from that, central co-operative banks have been undertaking normal commercial banking business also, such as attracting deposits from the general public and lending to the needy against proper securities.

**(3) Other Co-operative banks :**

**(A) Primary Agricultural Credit Societies (PACSS) :** An agricultural credit society can be started with 10 or more persons normally belonging to a village or a group of villages. The value of each share is generally nominal so as to enable even the poorest farmer to become a member. The members have unlimited liability, that is each member is fully responsible for the entire loss of the society, in the event of failure. Loans are given for short periods, normally for the harvest season, for carrying on agricultural operation, and the rate of interest is fixed. There are now over 92,000 primary agricultural credit societies in the country with a membership of over 100 million.

The primary agricultural credit society was expected to attract deposits from among the well to do members and non-members of the village and thus promote thrift and self-help. It should give loans and advances to needy members mainly out of these deposits.

**(B) Co-Operative Banks and Rural Credit :** Co-operative Bank was set up by passing a cooperative act in 1904. They are organized and managed on the principle of co-operation and mutual help. The main objective of co-operative bank is providing rural credit. The co-operative society act 1904 was amended in 1912 with a view to broad basing it to enable organization of non-credit societies.

The Co-operative bank has a history of almost 100 years. The Co-operative banks are an important constituent of the Indian Financial System, judging by the role assigned to them, the expectations they are supposed to fulfill, their number, and the number of offices they operate.

Their role in rural financing continues to be important even today, and their business in the urban areas also has increased phenomenally in recent years mainly due to the sharp increase in the number of primary co-operative banks.

Co-operative Banks in India are registered under the Co-operative Societies Act. The RBI also regulates the cooperative bank. They are governed by the Banking Regulations Act 1949 and Banking Laws (Co-operative Societies) Act, 1965.

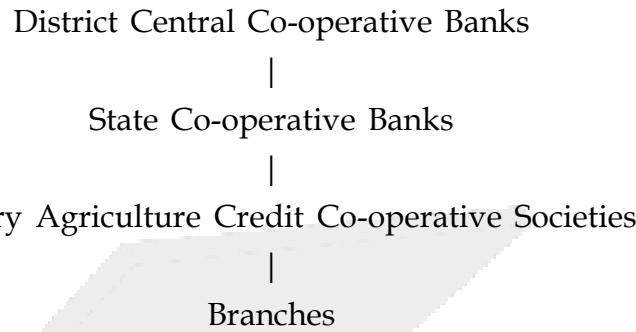
Co-operative banks in India finance rural areas under :

- Farming
- Cattle
- Milk
- Hatchery
- Personal finance

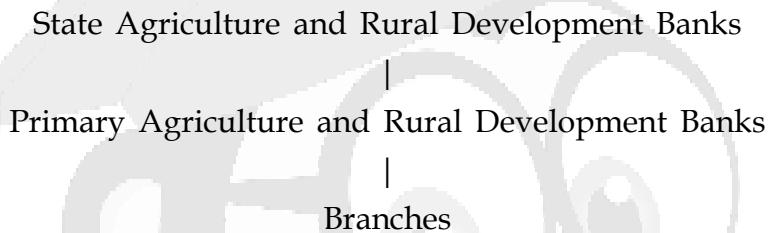
## Institutional Arrangements for Rural Credit (Co-operatives)

- Short Term Co-operatives
- Long Term Co-operatives

### Short Term Co-operatives



### Long Term Cooperatives



**(C) Commercial Bank and Rural Credit :** The commercial banks at present provide short term crop loans account for nearly 45 to 47% of the total loans given and disbursed by the commercial banks. Term loans for varying periods are given for purchasing pump sets, tractors and other agricultural machinery, for construction of wells and tube well, for development of fruit and garden crops, for leveling and development of land, for purchase of ploughs, animals, etc. commercial banks also extend loans for allied activities viz., for dairying, poultry, piggery, bee keeping, fisheries and others. These loans come to 15 to 16%.

### Functions of Co-operative Banks

Co-operative banks also perform the basic banking functions but they differ from commercial banks in the following respects

1. Commercial banks are joint-stock companies under the companies' act of 1956, or public sector bank under a separate act of a parliament whereas co-operative banks were established under the co-operative society's acts of different states.
2. Commercial bank structure is branch banking structure whereas co-operative banks have a three tier setup, with state co-operative bank at apex level, central / district co-operative bank at district level, and primary co-operative societies at rural level.
3. Only some of the sections of banking regulation act of 1949 (fully applicable to commercial banks), are applicable to co-operative banks, resulting only in partial control by RBI of co-operative banks and
4. Co-operative banks function on the principle of cooperation and not entirely on commercial parameters.

## (2) Non-Scheduled Bank

*Non-Scheduled Bank refers to the banks which are not listed in the Second Schedule of Reserve Bank of India.*

The banks which do not comply with the provisions specified by the central bank, within the meaning of the Reserve Bank of India Act, 1934, or as per specific functions, etc. or as per the judgement of the RBI, are not able to serve and protect the depositor's interest, are known as non-scheduled banks.

Non-Scheduled Banks are also required to maintain the cash reserve requirement, not with the RBI, but with themselves. These are local area banks.

- (i) Coastal Local Area Bank Limited
- (ii) Krishna Bhima Samruddhi Local Area Bank Limited
- (iii) Subhadra Local Area Bank Limited

## Credit Scores

If there is one financial product that has redefined the world of financial products, it has to be a credit card. These plastic cards may seem small and compact but contain a whole world of perks and benefits. With the world moving rapidly towards cashless transactions, credit cards are becoming one of those products that are indispensable. Credit cards do not just allow customers to borrow money against a credit and pay for their purchases, but it also provides a number of other benefits and privileges, such as Air Miles, dining discounts, waiver on fuel surcharge, shopping rebates and so on. In short, the importance of a credit card cannot be underestimated.

The usage of credit cards help to judge the creditworthiness of an individual. Using one of these products judiciously will enable the customer to become a creditworthy person, resulting in his receiving a number of benefits such as loans at low rates of interest. Credit rating companies such as TransUnion and Experian compile credit reports of an individual that has details of his credit score, account information and contact information, among others.

A *credit score* is a 3 digit numeric representation of a cardholder's creditworthiness. These numbers range between **300 to 900**. The closer the score is to 900, the higher is the cardholder's creditworthiness. An individual will have to try to stay between 700 to 900 in order to have an optimum credit score. This score is generated by a mathematical algorithm based on the information provided in the credit report and is designed specifically, to predict risk.

There are numerous models to generate credit scores, but the most common one that is in use is FICO credit score. Three major credit card bureaus generate this score and these three scores are widely used. The bureaus are Experian, Equifax and TransUnion. A credit score is generated based on the following information :

- History of payments
- Amount(s) that is owed
- New credit
- Types of credit that has been used
- Length of credit history i.e., time since account activity was started

The FICO score generated by each of the three bureaus may vary slightly, but usually fall in the same range. Customers are entitled to receive free credit reports but not a free credit score. A small amount must be paid to the credit card bureau by the cardholder to receive his/her credit score.

## Credit Rating

An analysis of all credit risks that is associated with a financial entity is known as credit rating. This is given to that particular company or entity based on their credentials, as well as the extent to which their financial statements are sound, based on the lending and borrowing that has been done by the company. This rating is in the form of a detailed report and helps other companies or Rating Agencies determine the solvency of that entity. Ratings are published by numerous agencies such as, Moody's Investors Service, Standard and Poor's and ICRA, based on detailed analysis.

## Difference between Credit Rating and Credit Score

A Credit Score and credit rating is sometimes used interchangeably but there are certain significant differences. These are :

- A credit rating expresses the creditworthiness of a government or a business whereas a credit score determines the creditworthiness of an individual.
- A credit rating is expressed in a letter grade format such as Triple-A ratings for those governments or corporations that have a healthy capacity for meeting all financial commitments followed by a double-A, A, Triple-B, Double-B and so on, until D for default. Pluses and minuses can also be added to these ratings.
- Credit scores are usually expressed in numbers such as Fair Isaac Corporation score or FICO score. These scores are 3 digit numeric representation of an individual's creditworthiness and range from 300 to 900. The closer the score is to 900, higher is the creditworthiness of that individual.

Both scores are however, provided by independent third parties.

## Credit Scores in India

The Reserve Bank of India has provided authorization to companies that have registered under The Credit Information Companies (Regulation) Act, 2005 to provide credit scores or ratings based on the past performances that have been reported by numerous member credit institutions and banks. CIBIL or Credit Information Bureau India Limited is India's leading credit information bureau. Other key players in India are Equifax and Experian. Credit scores are issued by the above three bureaus. The most sought after bureau in India is CIBIL, since it is the oldest player in the country, but lenders also use Equifax and Experian and hence it is mandatory for lenders to provide data to all of the above bureaus.

A credit score or rating is a direct indicator of the individual's or company's credit health. In case a reliable credit rating or credit score is maintained, it makes it easier for them to receive loans and additional credit cards without any hassle and at terms that is favourable to the customer. A good score or rating is an indicator that the individual is a low risk customer which is always an attractive prospect to potential lenders.

## How can Individuals get their Credit Scores?

Applicants can follow the steps given below to receive their credit scores :

- They can upload all the required information in any of the three credit bureaus - CIBIL, Equifax and Experian and avail their credit scores.
- They can also log in to the website of any of the three bureaus and request for the same.

Having a bad credit score or rating is highly undesirable in today's competitive economy. Individuals having a low credit score are deemed to be financially very risky and will not be able to receive loans at good interest rates or flexible tenures. Similarly, companies or governments that come with a bad credit rating are seen to be risky and will deter other companies or governments from doing business with them.

Customers can prevent the above from happening by not delaying their payments, by ensuring that their debts are paid on time and not having too many accounts. Having a good credit score or rating is essential to have a lot more financing options and hence should be given priority by customers as well as companies.



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